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Honorable Mayor and City Council
City of Costa Mesa
Costa Mesa, California

In planning and performing our audit of the financial statements of the City of Costa Mesa (the "City") as of and for the year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal controls that we consider to be material weaknesses. The matters below do not represent significant deficiencies in internal control, but are offered for your consideration as an opportunity to further enhance the City's system of internal control:

(1) Changes to the Vendor Master File

The accounts payable clerk currently has the ability to add new vendors and change existing vendors in the vendor master file. The accounts payable clerk is also responsible for entering invoices and processing them for payment. Under best practices, the function of modifying the vendor master file be separate from the function of the entering and processing of invoices.

Recommendation

We recommend that the City consider segregating the duties of accounts payable processing and updating the vendor master file or implement a periodic review of vendor master file. A report could be generated by the accounting system on a monthly basis that would identify any changes or modifications made to the made to the vendor master file. This report could be reviewed by someone in a management position and approval could be documented during this monthly review.

(2) Enhancing Controls in the Payroll Area

The City's Human Resources Department is the only department that has the ability to add new employees to the payroll masterfile. The City does hire individuals who are part-time or seasonal employees who remain in the payroll master file even if their status is deactivated. The City's payroll clerk, who is responsible for processing payroll, also has the ability to activate and deactivate existing employees, such as the part-time and seasonal employees identified above. To enhance controls, the ability to activate and deactivate employees should be limited to the Human Resources Department.

Recommendation

We recommend that the City review its system access rights and consider having the Human Resources Department be the only department with the ability to add, change or modify the payroll master file, including the activating and deactivating of employees.

(3) Financial Reporting Over Grants and Loans

The City receives approximately \$3 million of funding from Federal sources on an annual basis. The Federal funds are used by a variety of departments within the City. Certain situations were noted where Departments did not inform the Finance Department that the Federal Funds had been granted to, or received by, the City. Without this information being provided timely, it is difficult for the Finance Department to accurately report all federal expenditures on the Schedule of Expenditure of Federal Awards. It was also noted that a certain grant funded loan had not been properly reflected in the general ledger when the loan was originally made. Certain financial documents authorizing the loan had not been provided to the Finance Department. The documents for this loan were maintained by the Housing Department.

Recommendation

We recommend that procedures be implemented to ensure that all appropriate financial information for grants and loans are provided to the Finance Department timely to ensure accurate financial reporting.

(4) Ethics Policy

We evaluated the City's conformance to the best practices recommended by the Auditing Standards Board as a part of the new auditing standards that are now in effect. We noted that the City already has in place a number of practices to communicate its expectation of ethical behavior to all employees through verbal communications, trainings, and by setting proper tone at the top. However our audit procedures revealed the City does not have a formalized ethics policy. A well structured ethics policy establishes organizational standards for ethics, morals, and an overall "regard for the rules" philosophical approach within an entity. Specifically, matters such as honesty, integrity, compliance with laws and regulations, adherence to corporate policy, and upholding the City's high values and reputation are addressed. We also noted that the City's practices do not include a clearly communicated process for employees to report suspected fraud or other unethical conduct. A strong ethics policy is the foundation upon which an Organization builds its culture, which should then permeate all levels of personnel and guide all business dealings and transactions. This can be most effective in establishing a highly ethical and antifraud culture within any business organization.

Recommendation

We recommend that the City establish and implement an ethics policy. We also suggest that the City implement an effective reporting mechanism for fraud and other unethical conduct. Internal reporting channels, such as hotlines for anonymous tips, or a clearly defined reporting protocol (what to report, who to report to, etc.), have been found to be effective. Generally, centralized reporting to a party (such as Human Resources, etc.) outside the involved department have been found to be most effective.

This communication is intended solely for the information and use of management, those charged with governance and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Mayer Hoffman McGinnis P.C.

Irvine, California
December 8, 2010

Management Representations

We have requested certain representations from management that are included in the management representation letter dated December 8, 2010.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the ABLE's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the ABLE's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of Board of Directors and management of ABLE and is not intended to be and should not be used by anyone other than these specified parties.

Manager Hoffman McCombs P.C.

Irvine, California
December 8, 2010